Economic Outlook

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

January 1985

The prospects are favorable that the economy will continue to expand through 1985 and 1986 with relatively low inflation. Evidence mounts that the recent slowdown is nothing more than the normal hesitation in economic growth usually evident during the course of an expansion. Although areas of weakness will still be visible for several more months, a pronounced rebound in growth is likely, probably during the spring. Further enlargement of the U.S. merchandise trade deficit, however, will be a major drag on the economy this year.

The slowdown in the economy last year is evident in the pattern of real GNP growth. The annualized rate of increase in real GNP went from 10.1% in the first quarter to 1.6% in the third quarter. The Commerce Department's "flash forecast" for growth in the fourth quarter is 2.8%, but it seems that the preliminary estimate may be slightly higher. Real growth will likely remain subdued in the first quarter of this year but then show much improvement in the second and third quarters, as interest-rate-sensitive sectors of the economy respond to the decline in interest rates that began last fall and as the problem of excessive inventories is corrected. Real GNP is expected to post a moderate rise of 3.8% from the fourth quarter of 1984 to the fourth quarter of 1985, following an estimated increase of 5.5% from the fourth quarter of 1983 to the fourth quarter of 1984.

A slowdown in the economy similar to the current one occurred in 1976, as real GNP growth went from 9.1% in the first quarter to 2.3% in the third quarter. Growth improved slightly in the fourth quarter of 1976 and then shot up to 8.9%, 6.7%, and 6.8% in the first three quarters of 1977, only to be followed by another brief slowdown. The point is simply that economic growth typically does not proceed in a smooth, steady fashion but rather exhibits periods of ebb and flow even during broad expansions.

In particular months last summer and early fall, most of the major monthly economic indicators registered declines or paltry increases. Recent reports show decided improvement, however. The index of leading indicators fell by a significant 2.6% from April to July, but the 1.3% increase in November helped put the index 1.6% above the July level. Factory orders, excluding defense and automotive products, rose 1.3% in November. This was the first decent increase in several months, although it was not sufficient to bring orders up to the levels reached earlier in the year. Domestic auto sales rebounded in December to 8.3 million units at an annual rate from the October and November strike-affected levels of 6.9 and 7.1 million units, while in December average weekly hours in the manufacturing sector posted the largest increase since April.

All in all, signs of improvement in the economy are evident, although trouble spots are also visible. In particular, a very promotional pricing environment has led to substantial erosion of profit margins for many retailers. In addition, despite a narrowing of the merchandise trade deficit in October and November compared to the third-quarter average, the major challenge for many U.S. businesses in the period ahead will continue to be coping with a strong dollar, weak export markets, and surging imports.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual			1984	Forecast			1985	Actual	Forecast	
	I	II	III	IV	I	II	III	IV	1982-1983	1983-1984	1984-1985
Gross National Product	14.9	10.7	5.6	6.4	6.6	9.8	9.0	8.3	7.7	10.8	7.7
Real GNP	10.1	7.1	1.6	3.3	2.5	5.3	4.3	3.3	3.7	6.8	3.6
GNP Price Deflator	4.4	3.3	4.0	3.0	4.0	4.3	4.5	4.8	3.8	3.8	3.9

	Actual	Forecast	Actual	Forecast	
	1984:III	1984: IV	1982-1983	1983-1984	1984-1985
Consumer Spending	5.0%	6.4%	8.6%	8.6%	7.7%
Durable Goods	-4.3	7.5	14.2	13.6	7.2
Nondurable Goods	1.5	1.6	5.8	6.8	5.1
Services	10.5	9.6	9.4	8.7	9.7
Business Capital Spending	15.0	11.0	0.9	20.6	13.1
Structures	3.8	12.8	-8.7	15.6	12.1
Equipment	21.5	10.0	7.6	23.5	13.7
Residential Investment	-0.7	-6.0	44.6	16.3	3.7
			1983	1984	1985
Change in Inventories	$71.8b.	$55.5b.	$-13.5b.	$62.9b.	$47.3b.
Net Exports of Goods and Services	$-90.6b.	$-80.0b.	$-8.3b.	$-70.2b.	$-88.8b.
			1982-1983	1983-1984	1984-1985
Government Purchases	9.6%	9.7%	5.4%	9.0%	9.9%
Federal	7.9	9.5	4.2	8.9	12.1
Defense	-0.8	10.8	11.7	9.8	10.5
Other	36.4	6.0	-12.7	6.2	16.9
State & Local	10.8	9.9	6.2	9.0	8.4
Corporate Profits Before Tax	-1.1*	0.7*	22.8	5.1	6.4
Corporate Profits After Tax	-0.6*	1.3*	21.6	6.4	6.4
Plant and Equipment Expenditures	14.5	11.0	-4.8	14.3	10.2
Real Final Sales#	-1.0	5.3	3.2	4.8	4.1
Real Disposable Personal Income	3.9	3.6	3.5	6.7	4.3

Economic Indicators	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	4.8%	4.8%	2.4%	3.8%	4.1%	4.5%
Producer Price Index for Finished Goods**	-2.4	-2.4	6.0	0.6	1.8A	3.9
Industrial Production	-7.2	-4.8	4.8	6.5	10.7	4.3
Retail Sales##	1.5	0.1	1.8	9.3	10.7	8.3
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.3	9.7	9.8	9.2	10.4A	10.6
Housing Starts (millions of units, a.r.)	1.68	1.54	1.53	1.70	1.77	1.66
Unemployment Rate	7.4%	7.3%	7.1%	9.6%	7.5%A	6.8%
Merchandise Trade Deficit (a.r.)	$151.8b.	$110.2b.	$119.2b.	$69.4b.	$128.0b.	$148.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

January 11, 1985

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
$b. = billions a.r. = annual rate F = Forecast

*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
A = Actual